SOME PROBLEMS IN OVERDUE PAPER.[1]

PERHAPS in no branch of their jurisprudence have the learned judges of a race that is pre-eminent for its commercial instincts and its facile ingenuity in devising simple and accurate business methods, wandered so far astray from the logical development of fundamental principles as they have in their adjudications on questions of mercantile law, which at this day have intrinsically neither in themselves nor from the custom of merchants any apparent legal difficulty. Lord Mansfield, in his wise desire that the principles of commercial law should subserve and be consistent with mercantile usage, placed the foundations of this branch of the Common Law upon broad and solid bases. But the new questions which have arisen since his time for the most part have not been developed or settled upon any logical deduction from the previously established legal principles. Excrescences upon well recognized legal doctrines and inexplicable confusion have taken the place of an orderly and scientific and logical growth. Learned judges have snatched at catch phrases of legal maxims, and have blindly applied them in the disposal of cases before them. They have made exceptions to general rules without apparent reason, and distinctions without legal differences, and in one instance at least they have engrafted upon what is ostensibly the same negotiable instrument the possibility of its importing different rights according to the occult facts attendant upon its inception.[2] Even so great a lawyer and judge as Lord Ellenborough decided two cases involving the same principles of commercial law in different ways.[3] It would be invidious to animadvert upon the causes and reasons for this most unsatisfactory and amorphous state of the law mercantile in general, and of that branch of it which deals with the question of the rights and equities in overdue negotiable paper in particular. But it is not too

[1] I wish to gratefully acknowledge my indebtedness to Professor James Barr Ames for the use of his collection of the authorities, and for other material aid, and to Mr. James Parker Hall and Hugh Walker Ogden, Esquire, for the use of their notes taken in the classroom in February and March, 1896.

[2] Minot *v.* Russ, 156 Mass. 458.

[3] Crossley *v.* Ham, 13 East, 498; Dunn *v.* O'Keeffe, 5 M. & S. 282.

much to say that the latter resembles a battered old hoopskirt, "without form and void," which has been raked from the ash-heap of abandoned legal principles.

It would be neither interesting nor instructive to attempt a discussion of many of the cases which relate to this subject, but there are some legal problems which are presented by some of the adjudications that, when analyzed, possess at least the interest of wonder. Indeed, some of these decisions are so curious, and have departed so far from any logical thesis, that on the one hand they appear to be for the most part *sui generis* and incomparable to anything else in our law, and on the other hand the different classes of cases seem to be irreconcilable with one another, either upon the legal theory upon which they were adjudged or upon any other conceivable legal doctrine. If therefore there be any legal principle upon which a majority of the actual decisions in this branch of the law can be reconciled and explained, its discovery and enunciation would be a most valuable contribution to the science of our jurisprudence, and I earnestly hope that the present attempt at a succinct presentation of some of the cases and the problems which they create may give rise to a salutary discussion of the subject. Whatever conclusions I have come to or may state are at most tentative, and I wish to affirmatively deprecate any accusation of dogmatism.

There are three theories of overdue negotiable paper, no one of which has been consistently adopted by the Common Law. It is consequently difficult, if not impossible, to get either a correct perspective from which to view the cases or an absolute standard by which to measure their correctness. It appears to me to be impossible to follow the ordinary method and test the correctness of a case relating to overdue negotiable paper by the application of the logical deduction and modification of the principles which underlie the law of negotiable paper before maturity, because to do so would be to condemn almost every case to the limbo of legal error. It would have been easy, and far more satisfactory, if the decisions had been placed upon what apparently ought to be the true doctrine, namely, that the only change that maturity makes in a negotiable instrument is that it gives notice on its face that the obligor has not fulfilled his contract, and that therefore he either has a valid defence or is bankrupt, and the purchaser of such an overdue instrument takes it with this notice, just as

he would take it before maturity, subject to any defences of which he had notice. Consequently, it is too clear for argument that upon this theory the purchaser after maturity, in good faith and without actual notice of any infirmity, ought not to be liable to outstanding equities in favor of former parties who have owned the instrument, or of outside persons. The title to negotiable paper passes in the same way and by the same means after its maturity as before, and the purchaser for value in good faith of the legal title of anything, whether it be land or personalty, ought not to be subject to any claims or equities against that title of which he had no notice. But the courts have treated many, if not most, of the questions which have arisen concerning overdue commercial paper as analogous to, if not strictly identical with *choses in action.* Yet they have allowed the transferee of such overdue paper to sue in his own name. It seems to me that this fact is a fundamental objection to the theory that an overdue negotiable instrument is a *chose in action.* It is not a sufficient answer to say that, although it is a *chose in action,* the holder can sue in his own name by the custom of merchants; for, in the first place, if a negotiable instrument before maturity be a negotiable *chose in action,* which in some of its aspects it certainly is, when it is shorn of its negotiability, as it must now be taken to be settled that it is the moment that it becomes due, it *ex vi termini* has lost its attribute of being so transferred, for negotiability means that the legal title to a right of action is capable of such transfer that the transferee can sue in his own name. The transference of the legal title is the test, the right to sue in the assignee's name being merely incident to such transfer. Furthermore, there is the objection to the doctrine, that upon it that class of cases cannot be explained which hold that, where the holder before maturity has made some contract in regard to the security, the equity cannot be followed into the hands of a purchaser after maturity; for it is conceived that in every case of a *chose in action,* whether by statute or otherwise the transferee is allowed to sue in his own name, he can acquire only the rights of the transferer, and must work out his rights through the original obligee. It seems therefore that a negotiable instrument must be at least more than a negotiable *chose in action,* and it certainly has many of the attributes of a chattel. Unlike a *chose in action,* its possession is essential to the enforcement, and its delivery to a transfer, of the obligation which it imports,

and it has a substantial value. As Professor Ames has felicitously said, "The holder's right *in personam* is dependent upon his having a right *in rem*." [1] Moreover, trover can be maintained for a negotiable instrument even after it is due; it may be the subject of gift *mortis causa;* it is "goods and chattels," within the Statute of Frauds, and it can be taken on execution. [2] There would seem to be, on principle, no difficulty in the adoption of the doctrine that such an instrument is a chattel importing contractual rights, as any other chattel imports rights of user, and that it is negotiable before maturity, and upon its becoming due loses its negotiability. Yet there is a large class of cases, to be referred to hereafter, which have apparently settled the law on one point, and which can be explained upon such a theory only with the greatest difficulty, and by referring them to the law of agency. The truth seems to be that the law has treated overdue negotiable instruments both as chattels and as *choses in action*, and further, at times, as something else that is distinctly *sui generis* and unnamed. The supreme difficulty, however, in dealing with the subject is that the courts have ignored to a most surprising extent the question of legal title, and yet I conceive that that is the fundamental one in these cases, as it always is wherever there are conflicting equities.

Although there are comparatively few cases on overdue negotiable instruments, I shall not attempt to cite all of them, my purpose being to show some of the propositions that seem to have been settled by them, and to suggest other questions which might arise, but which so far as I am informed, have not been passed upon by any court. In the first place, therefore, it having been held that if a negotiable instrument indorsed in blank or payable to bearer is stolen and negotiated before maturity to a *bona fide* purchaser for value, the latter can enforce the obligation against the obligor, and retain the fruits of his purchase,[3] it would be interesting to see what a court would do if, instead of suing the original obligor, the purchaser sued the last indorser, from whom the bill or note was stolen. It is conceived that in such a case the indorser would have no more of a defence than the maker or drawer, and would be compelled to fulfil his contract. On the other hand, it has been repeatedly held

[1] 2 Ames, Bills and Notes, 799. [2] Ibid.

[3] Miller *v.* Race, 1 Burr. 452; Grant *v.* Vaughan, 3 Burr. 1516; Peacock *v.* Rhodes, 2 Doug. 633.

that, if the negotiable instrument is stolen after its maturity, the transferee from the thief who has purchased for value and in good faith gets no title to the instrument, and can keep neither it nor its proceeds as against the one from whom it was stolen.[1]

And likewise the same has been held where the theft was perpetrated before the maturity of the instruments, but the thief did not transfer them until after their maturity.[2]

If a *bona fide* purchaser before maturity gets an obligation unimpeachable even by the one from whom it has been stolen,[3] it must be because he gets the title to it. Yet it is difficult to see how a thief either gets or can confer title to his transferee, unless the analogy of the doctrine of *market overt* is adopted. On the other hand, however, even in the case where the security is stolen after its maturity, there can be little doubt, despite an intimation to the contrary which escaped the learned Mr. Justice Lord in delivering the opinion of the court in Hinckley *v.* Union Pacific Railroad,[4] that if a *bona fide* purchaser from the thief presents it to the obligor, who pays it in good faith and without notice, such obligor would be protected from paying again, for he has simply fulfilled his contract; and this seems to prove that the transferee from the thief gets the title. It is therefore difficult, if not impossible, to explain why or how the owner from whom it was stolen can recover from the purchaser, for his claim can be nothing more than an equity, and the purchaser for value without notice is universally protected against the prior equities of third parties, and this would seem to be true in some cases also even of a purchaser of a *chose in action* from the true owner, for the assignee would clearly acquire a legal power of attorney, the title to which ought to be protected. In either aspect, therefore, whether an overdue security be a chattel or a *chose in action*, or partly one and partly the other, it is difficult to support upon principle the

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[1] Down *v.* Halling, 4 B. & C. 330; Greenwell *v.* Haydon, 78 Ken. 332; Davis *v.* Bradley, 26 La. Ann. 555; Weathered *v.* Smith, 9 Tex. 622; Walker *v.* Wislon, 79 Tex. 185; Arents *v.* Commonwealth, 18 Gratt. 750.

[2] Von Hoffman *v.* United States, 18 Ct. Cl. 386 (overruled on the point that the instruments were overdue, 113 U. S. 476); Cornell *v.* District of Columbia, 20 Ct. Cl. 229; Gilbough *v.* Norfolk & Petersburg Railroad Co., 1 Hughes C. C. 410; Wylie *v.* Speyer, 62 How. Prac. 107; Northampton Bank *v.* Kidder, 106 N. Y. 221; Evertson *v.* National Bank of Newport, 66 N. Y. 14; Texas *v.* White, 7 Wall. 700; Texas *v.* Hardenberg, 10 Wall. 68; Vermylie *v.* Adams Express Co., 21 Wall. 138; Hinckley *v.* Merchants' National Bank, 131 Mass. 147.

[3] Grant *v.* Vaughan, 3 Burr. 1516.

[4] 129 Mass. 52, 60.

second block of the above cited cases, since it is not a question of prior or even of equal equities. And this suggestion finds support at least in the fact that where the bill was indorsed to the plaintiff after its maturity by one who had purchased in good faith and without notice before its maturity, the acceptor could not avail himself of the defence that the bill was drawn for a debt contracted in an illegal transaction;[1] and this seems to be the settled law.[2] It is therefore by no means true that even at law the transferee of overdue paper takes it subject to all the equities. But, starting with that proposition as the controlling and fundamental doctrine, there are a number of curious decisions to the effect that where a negotiable security has been transferred to an agent for some specific purpose, such as for collection or for discount, and the bailee has misused it by negotiating it for his own benefit after its maturity, the bailor can recover from the innocent purchaser for value from the bailee.[3] Turner *v.* Hoyle[4] is obviously to be disposed of upon the same principles as the above, and in line with these decisions it was accordingly held that trover could be maintained against a purchaser for value without notice of an overdue note from a trustee who had fraudulently converted it to his own use; and In re European Bank,[5] is a similar case, where the fraudulent transferrer was a constructive trustee. To the same class of cases also must be added Chase *v.* Whitmore,[6] Bird *v.* Cockrem,[7] and West *v.* McInnes,[8] in each of which an agent discounted with authority so to do a note with his principal's funds, and after maturity wrongly converted it to his own use by transferring it to a purchaser for value without notice.

It cannot be doubted that the title to a note or bill of exchange payable to bearer or indorsed in blank and government bonds passes merely by delivery, whether the transfer be before or after maturity; and so in all of these cases, notwithstanding the remarks of Mr. Justice Heath in Goggerley *v.* Cuthbert,[9] that "the delivery of the

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[1] Chalmers *v.* Lanion, 1 Camp. 383.

[2] 1 Ames, Bills and Notes, 691, n. 3.

[3] Lee *v.* Zagury, 8 Taunt. 114; Kerr *v.* Straat, 8 Q. B. U. C. 82; Foley *v.* Smith, 6 Wall. 492; Thomas *v.* Kinsey, 8 Ga. 421; Towner *v.* McClelland, 110 Ill. 542; McCormick *v.* Williams, 54 Iowa, 50; Henderson *v.* Case, 31 La. Ann. 215; Stern Brothers *v.* Germania Nat Bank, 34 La. Ann. 1119; Emerson *v.* Crocker, 5 N. H. 159; Farrington *v.* The Park Bank, 39 Barb. 645; Huddleston *v.* Kempner, 3 Tex. (Civil App.) 252; Goggerley *v.* Cuthbert, 2 B. & P. n. r. 170; Ford *v.* Phillips, 83 Mo. 523; Proctor *v* McCall, 2 Bail. S. C. 298.

[4] 95 Mo. 337.

[5] L. R. 5 Ch. App. 358.

[6] 68 Cal. 545.

[7] 28 La. Ann. 70.

[8] 23 Q. B. U. C. 357.

[9] 2 B. & P. n. r. 170, 171.

bill was not absolute, but conditional, and was in the nature of an escrow," and of Mr. Justice Chambre, in the same case and on the same page, that "the plaintiff only parted with a possession of the bill," it cannot be doubted that the agent or the trustee gets the title to the instrument, and that he is therefore more than a bailee, for if the attempt be made to deliver it in escrow, it cannot be any more successful than the attempt to deliver a deed in escrow to the grantee. The agent can sue upon the instrument in his own name, and where it is transferred to him for collection it is the intention of the principal that he should do so, if necessary, and where, as in Goggerley *v.* Cuthbert,[1] the agency is to procure the discount of the instrument, it is obvious that the agent has authority likewise to pass the title. Of course, too, a trustee must have the title. Obviously, therefore, in all these cases, if an overdue negotiable instrument is a *chose in action*, the agent or trustee possesses the title thereto, which, it is believed, is a legal power of attorney, and on a sale of that power a purchaser for value without notice ought to be protected. If, on the other hand, it is simply a question of equities, which is the theory upon which all the above cases have been decided, and upon which, it must be admitted, almost every case in the books has treated disputed rights in or to a *chose in action*, there can be no doubt that those cases, where the transfer of the security to the agent or trustee has been after its maturity, were decided not only in accordance with the great weight of authority, but also in consonance with the principle which has just been indidicated. For in such cases the purchaser must still work out his right through the original holder of the *chose in action*, who was not the agent, and so he could not get any further rights than those the agent had, it being impossible for the latter to assign more or greater rights than he held. And the same would be true of a trustee. But it is believed that those cases where the agent or trustee held the legal title to the *chose in action*, having obtained the title to the security before its maturity, although rightly decided upon the ordinarily accepted doctrine of the transfer of *choses in action*, for then both the principal or *cestui que trust* and the purchaser had an equity against the fraudulent fiduciary, and that of the former was prior, were decided wrongly upon principle, because then the purchaser would have obtained a legal power of attorney from the fiduciary, and the original holder would have only his equity against the fiduciary.

[1] 2 B. & P. n. r. 170.

On the other hand, if the chattel attributes of negotiable instruments preponderate and obtain, it can be confidently asserted that the cases under discussion were wrongly decided, because the fiduciary manifestly had the title, and conveyed it to a purchaser for value without notice. It is conceived, however, that in any event some element of the law of agency has entered into the disposal of these cases, the characteristic policy and tendency of which are the protection of the principal.

Opposed to these numerous adjudications are Bradford *v.* Williams,[1] Parker *v.* Stallings,[2] Connell *v.* Bliss,[3] Eversole *v.* Maull,[4] and Lee *v.* Turner,[5] an extended treatment of which does not seem to be necessary. The two decisions by the Supreme Court of North Carolina go upon the distinct ground that the real owner had given the title to his agent and authority to dispose of it as his own. The Maine case went off upon the ground of negotiability, the Chief Justice expressly saying that "the dishonor of the note had no tendency to affect the defendant with notice that the title was not in" the agent; and the Maryland and Missouri cases were determined upon the very questionable ground of estoppel that has been applied and established in New York, to the effect that one who has given the ostensible title to another is estopped from setting up the real facts against a purchaser for value without notice.[6] The doctrine of McNiel *v.* Tenth National Bank,[7] has been so often erroneously applied in the disposal of cases, and its rightful applicability is so dependent upon the particular facts of each case, that it seems to be impracticable to enter upon a discussion of it in this article.

There is another class of cases which obviously involves the same principles of law, and is strictly analogous to those in which the holder who has fraudulently transferred the instrument after its maturity has been an agent, where one wrongfully obtains or without right retains its possession and fraudulently transfers it to an innocent purchaser after its maturity. In Wood *v.* McKean,[8] the payee of a note indorsed it in blank and transferred it as collateral security. He afterwards paid the debt without procuring the return of the note, and after its maturity the holder transferred

[1] 91 N. C. 7.
[2] Phillips (N. C.), 590.
[3] 52 Me. 476.
[4] 50 Md. 95.
[5] 89 Mo. 489.
[6] McNiel *v.* Tenth National Bank, 46 N. Y. 325; Moore *v.* Metropolitan National Bank, 55 N. Y. 41.
[7] 46 N. Y. 325.
[8] 64 Iowa, 16.

it to the defendant for value. It was held that the payee could recover, and to the same effect is Osborn *v.* McClelland[1] and the cases of Church *v.* Clapp,[2] McKim *v.* King,[3] and Midland Railroad Company *v.* Hitchcock,[4] where the possession of the instrument was procured from the owner for some specific purpose, and then fraudulently misappropriated after its maturity, are of course similar, and were decided in accord with Wood *v.* McKean.[5]

It is believed that these cases are not to be supported, for the same reasons and upon the same principles that have been indicated already in regard to the prior cases. Indeed, there are three adjudications in which a diametrically opposite result was reached.[6] In Moore *v.* Moore the indorsement of the note in question was procured by fraud, and the title came to a *bona fide* purchaser after maturity, and Mr. Justice Mitchell, delivering the opinion of the court, said: "It is familiar law that if the owner, although induced thereto by fraud, invests another with the apparent legal title to chattels, in pursuance of a contract, the person so clothed may transfer an unimpeachable title to a good faith purchaser. We are unable to discover any good reason for a distinction in that regard between chattels and such instruments as may be assigned by endorsement, so as to give the assignee a complete legal title."[7]

The question of legal title is strongly brought out in Etheridge *v.* Gallagher,[8] where Etheridge had taken two notes in payment for land, and agreed to convey the land upon the payment of the notes. He afterwards transferred one note to Eiland in part payment for another piece of land bought by him, the title to which failed, and, Eiland having transferred the note to Gallagher after it was due, suit was brought upon it, and Etheridge set up the above fact of failure of consideration as a defence, and it was rightly held that, Gallagher having acquired the legal title, it was not subject to be defeated by outstanding equities; and of the same import are Hibernian Bank *v.* Everman,[9] Hill *v.* Shields,[10] Crosby *v.* Tanner,[11] and Blake *v.* Koons.[12] It appears to me that hardly any one can doubt the validity of these cases. Yet it is submitted that they cannot be explained upon the theory that an overdue security

[1] 43 Oh. St. 284.
[2] 47 Mich. 257.
[3] 58 Md. 502.
[4] 37 N. J. Eq. 549.
[5] 64 Iowa, 16.
[6] Neuhoff *v.* O'Reilly, 93 Mo. 164; Cochran *v.* Stewart, 21 Minn. 435; Moore *v.* Moore, 112 Ind. 149.
[7] 112 Ind. 152.
[8] 55 Miss. 458.
[9] 52 Miss. 500.
[10] 81 N. C. 250.
[11] 40 Iowa, 136.
[12] 71 Iowa, 356.

is a *chose in action*, for that principle embodies the fundamental doctrine that one must work out his rights to a *chose in action* through the original and only legal holder, and consequently the defendant can take advantage of any defence which he may have, whether that defendant be an indorser or the obligor. It is believed that in such cases as these, if an overdue note is a *chose in action*, the one who has an equity ought not to be allowed to recover back the instrument or its proceeds, but that clearly the *bona fide* purchaser should be entitled to keep whatever he has got. He is at least the purchaser of a legal power of attorney to reduce the *chose in action* to possession, and although therefore he may maintain a suit against the obligor, yet, being obliged to work out his rights through the original owner of the *chose in action*, he cannot maintain a suit against one who has an equity against that original owner. As, for instance, in Etheridge *v.* Gallagher,[1] Gallagher had a right to maintain an action against the maker of the note, but, being obliged to work out his rights against Etheridge, the indorser, through Eiland, he could not recover from him. Consequently, the case must be explained upon one of the other two theories of overdue paper, upon either of which it is obvious that it can be supported.

The case of Theisen *v.* Dayton,[2] which has been sometimes cited as *contra* to the above, has in reality nothing whatever in common with them, being simply a case where the first mortgagee foreclosed and bought in, securing also a conveyance of the equity of redemption, from the vendee of the mortgagor. The vendee had meanwhile bought in the second mortgage and notes. It is evident that, the latter having assumed their payment, the mortgage and notes were paid and extinguished by his buying them in, and therefore his transferee after maturity obtained nothing, and it was so held.[3]

There is one more case that is analogous, and that appears to require some consideration. In Kernohan *v.* Durham,[4] Durham paid two mortgage notes, which he had given to McGill by executing and delivering to him a new note and mortgage. McGill after they were due, having neglected to deliver them up or cancel them, pledged the old notes to one Kinney for a loan. Thus far the legal situation, it is clear, was that McGill was the constructive trustee

[1] 55 Miss. 458.
[2] 82 Iowa, 74.
[3] Cuvillier *v.* Fraser, 5 Q. B. U. C. 152.
[4] 48 Oh. St. 1.

of the old notes for Durham, and that, as the law is, Durham could recover them from any one into whose hands they were transferred ;[1] and moreover that Durham had paid them and could not be sued upon them,[2] and it was so held. But this was not the end of McGill's wrongdoing, for he pledged a forged copy of the new note before its maturity to Kernohan, and after its maturity he pledged the genuine copy to Coddington, upon which Durham had made some payments. McGill, then, was at most a constructive trustee of the new note and the payments made upon it for Kernohan ; and he transferred it to an innocent purchaser for value after maturity. It was held that Kernohan was able to follow his equity to the note into such purchaser's hand. Of course this case cannot be reconciled with those that have been cited immediately prior, and can only be supported upon the theory that an overdue note is a *chose in action*, and the adoption as correct of the principle of *choses in action* as established by the weight of authority. But it is also a curious case in another aspect, for if an overdue note is a *chose in action*, Kernohan apparently, having contracted for a negotiable security, neither asked for nor obtained sufficient relief.

It has occurred to me that there could not well be a better conclusion to this article, both as an epitome and commentary upon it and upon the law which it has sought to set forth, than the words of the learned Mr. Chief Justice Gilfillan, delivering the opinion of the court in Cochran *v.* Stewart[3]: "It is not necessary to decide here whether, as a general rule, the assignee of a *chose in action* takes it subject to all equities, as well of third persons as of the debtor or obligor. But we will go so far as to hold that if an owner of a *chose in action*, intending to pass the absolute title, executes an absolute assignment, and delivers with it the evidences of the *chose in action*, his assignee may transfer to a purchaser for a valuable consideration, and without notice, just the title which he appears to have by the assignment and possession of the evidences of the debt. McNeil *v.* Tenth National Bank.[4] In this regard, we see no difference between transfers of *choses in action*, and of other personal property."

Francis R. Jones.

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[1] Turner *v.* Hoyle, 95 Mo. 337 ; *In re* European Bank, L. R. 5 Ch. App. 358.
[2] Cuvillier *v.* Fraser, 5 Q. B. U. C. 152.
[3] 21 Minn. 435, 440.
[4] 46 N. Y. 325.